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IN THE

Supreme Court of the United States

October Term, 1949

No. 59

REO MOTORS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR PETITIONER.

JAMES O. WYNN,
N. BARR MILLER,
Attorneys for Petitioner,
Investment Building,
Washington 5, D. C.

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I.

The petitioner for 1941 had an excess of deductions allowed by Chapter I of the Internal Revenue Code over gross income computed under said chapter, regardless of whether "said chapter" means said chapter as it applied to 1941 or said chapter as it applied to 1942; in other words, petitioner had a net loss for 1941.

The last sentence of the first paragraph beginning on page 4 of respondent's brief states that "With the addition of the $1,551,902.79 loss in respect of Reo Sales stock, taxpayer *would have had* * a net loss for 1941". The inference (probably not intended) is that, for the purpose of deter-

* Italics supplied.

mining a net loss for 1941, the loss of $1,551,902.79 should perhaps not be included among the deductions.

At no stage in this case has the respondent ever contended that the loss of $1,551,902.79 was not sustained. In his brief in this Court, he concedes this to be the fact (last full sentence, p. 3, Resp. Br.; footnote 8, p. 22, Resp. Br.).

The respondent also concedes that said loss of $1,551,902.79 was allowed as a deduction by Chapter I of the Internal Revenue Code (last sentence beginning on p. 3, Resp. Br.; second indented sentence, p. 5, Resp. Br.).

The said loss of $1,551,902.79, when added to petitioner's "other allowable deductions totalling $2,215,727.08" (footnote 8, p. 22, Resp. Br.) brings the total of deductions allowed by Chapter I of the Internal Revenue Code to $3,767,629.87.

Petitioner's gross income for 1941 was $2,573,259.89 (footnote 8, p. 22, Resp. Br.).

There was thus, in 1941, an excess of deduction allowed by Chapter I of the Internal Revenue Code over gross income—there was thus a net loss for 1941—of $1,194,369.98.

II.

Respondent has incorrectly stated the petitioner's contention.

In the second sentence beginning on page 8 of respondent's brief it is stated that "Taxpayer contends that the amended section 23(g)(4) * * * is * * * applicable in computing net operating loss for 1941 for the purpose of a carrying over net operating loss deduction (*sic*) in 1942".

On the contrary, we contend that in applying the "exceptions, additions and limitations" provided in section

122(d)(4) to the admitted net loss for 1941 (Point I of this reply brief) for the purpose of determining a net operating loss deduction *for 1942*, the language of section 122(d)(4) should be given the meaning assigned to it by the law applicable to 1942.

The basic premises upon which the petitioner rests its case, which we believe are so fundamental as to bar controversy, are as follows:

1. The law applicable to the year 1942 determines whether a net operating loss deduction is to be allowed in the computation of 1942 tax liability. This is not contested by the respondent.

2. The amount of the net operating loss deduction allowable in the year 1942 is also determined by the law applicable to the year 1942. This is also apparently accepted by the respondent.

3. Congress has the power to provide that either the allowance, or the amount, of a net operating loss deduction shall be determined under the law applicable to some other year. Petitioner does not deny, therefore, that Congress might in the law applicable to 1942 have provided that the amount of a net operating loss deduction allowed in 1942 should be computed by reference to the law applicable to 1941. This, however, would amount to nothing more than an incorporation by reference, and would not change the fact that it is the law applicable to 1942 which determines the amount of the deduction by providing that the deduction should be computed in the same manner as is provided in the 1941 law.

4. In the absence of any provision in the law applicable to 1942 providing that the deduction should be computed in the manner provided in some other law, specifically 1941 in this case, the amount of the deduction must be computed in

the manner provided generally in the law applicable to the year 1942.

The issue in this case, and the only issue, is, therefore, whether Congress in providing for the allowance in 1942 of a net operating loss deduction provided that the amount of that deduction must be computed with the "exceptions and limitations" of section 122(d)(4) of the law applicable to 1941. If the answer is in the affirmative, then the decision below must be affirmed. If it is in the negative, then the petitioner must prevail.

III.

In case of conflict between United States Courts of Appeal for different circuits, there is no presumption that one court is right and the other wrong.

In the last sentence beginning on page 12 of respondent's brief, it is asserted that the "conclusion" "that the decision in *Commissioner* v. *Moore, Inc.* * * * is correct" "can only be accepted after the conflicting decision below is shown to be wrong".

The respondent thus takes the position that the United States Court of Appeals for the Fifth Circuit is wrong until it is proved to be right, and the United States Court of Appeals for the Sixth Circuit is right until it is proved to be wrong.

We submit that there is no such presumption.

IV.

Many, if not most, of the matters argued in respondent's brief relate to issues not raised by the facts in this case.

As the respondent has reiterated several times in his brief, the computation of a net operating loss deduction in-

volves several steps (pp. 16-~~17, 39-41~~). The initial step, as provided in section 122(a), is to determine "the excess of the deductions allowed by this chapter over the gross income". It can be argued that conceivably a case may arise in which it will be important to determine whether by the words "by this chapter" Congress was referring to "this chapter" as it existed in the year in which the deduction is being granted or the year in which the original net loss arose. A taxpayer who in 1942 looks at the law then in effect to determine whether he has a net operating loss deduction allowable in 1942 may, with considerable justification, assume that "by this chapter" is meant the chapter as it then exists in 1942. The respondent assumes that "by this chapter", Congress meant the chapter as it previously existed. We suggest that it is entirely unnecessary in this case to argue which of those position would be correct. The petitioner has the identical "excess of the deductions allowed by this chapter over the gross income" regardless of whether "this chapter" refers to "this chapter" as it existed in 1941 or 1942 (Point I of this reply brief). We submit, therefore, that when the respondent argues that the position contended for by the petitioner, in the instant case, means that a deduction not allowable in the computation of 1941 tax liability would be allowable in the computation of the net operating loss deduction allowable in 1942, and when he sets forth in his brief the allegedly horrible examples flowing therefrom, the respondent is arguing some other case which he apparently prefers to argue but is not meeting the issue involved in this case.

What the petitioner is arguing in this case is that whether the "excess of the deductions allowed by this chapter over the gross income" must be computed under the 1942 or the 1941 law, a question not necessary for decision, the "exceptions, additions and limitations provided in sub-

section (d)" of section 122 must be computed under the law applicable to the year 1942 (Point III of this reply brief).

Even if Congress intended that the excess of deductions over gross income should be computed under the 1941 law, it does not follow that Congress also intended that the "exceptions, additions and limitations provided in subsection (d)" must also be computed under the 1941 law.

When a decision is once made that a net operating loss deduction will be allowed, that means that a net loss for some other year will be allowed as a deduction in the current year, which necessarily creates other questions requiring decision. For example, if Congress in the year 1942 decided for the first time that there should be allowed as a deduction in computing 1942 income a net operating loss carried over from 1941 to 1942, Congress would be immediately faced with the subsidiary question: Shall the excess of deductions over gross income for 1941 be computed under the 1941 or the 1942 law? *

---

* While it is not necessary to a decision in this case, we suggest that one argument for applying the 1942 law is that the deduction allowable in 1942 should rationally be computed on the basis of what is then believed to be the proper and appropriate method for computing the income to be included and the deductions to be allowed, and not upon the basis of what was formerly thought to be correct but now found to be deficient, as is evidenced by the fact that the law has been amended. The Internal Revenue Code is a constantly growing body of law. It is to be presumed that when Congress makes a change, it intends the change to be an improvement, to be availed of thereafter. For example, on the facts in the instant case: The worthlessness of the stock of Reo Sales would not have been a capital loss under the Code as it applied to 1941 except for the provisions of section 23(g). In amending section 23(g) in the Revenue Act of 1942, Congress realized that the old rule was in some cases too harsh. The change was intended as an improvement. Why then should the improvement not be used in subsequent computations required by the law?

Congress, having made the decision (whatever it may have been) that either the 1941 or the 1942 law should govern in determining the excess of the deductions over gross income for 1941, would still have other decisions to make. "Should the full amount of such excess of deductions over gross income be allowed as a deduction in 1942?" If the answer is in the negative, then the question arises "What exceptions, additions and limitations shall be made and under what law shall they be computed?" The arguments which may have influenced the decision (assuming it was so decided) that the excess of deductions over gross income should be computed under the 1941 law would have no application to the decision as to whether the "exceptions, additions and limitations" should be computed under the 1941 or 1942 law.

If we eliminate from the respondent's brief the arguments directed solely to support the proposition that the "excess of deductions allowed by this chapter over gross income" should be computed under the law applicable to 1941 rather than the law applicable to 1942, there will not be much left. When Congress in 1942 states that a loss from 1941 shall be allowed in 1942, with adjustments, there is no logical reason to assume that the adjustments to be made should be made under any law other than the one applicable to 1942. There are no reasons of policy, convenience or fear of allegedly dire results which would influence Congress to require that the adjustments be made under some law other than that applicable to 1942. Congress has not provided that the adjustments shall be made under any law other than that applicable to 1942 and, accordingly, there is no law other than the 1942 law to be applied. In addition, the only Congressional statement bearing on the question supports fully the proposition that the 1942 law governs the "exceptions, additions and limitations" required to be made (see Point VIII of this reply brief).

Similarly, much of respondent's argument in his brief is addressed to the possibility of a net operating loss of a given year being carried back to the first or second preceding years or being carried over to the second succeeding year.

The facts in this case are extremely simple. Petitioner had in 1941 an excess of deductions over gross income. *If* the language of section 122(d)(4) is to be given the meaning assigned to it by the law applicable to 1942 (the taxable year for which we are computing net income and determining liability for tax), said excess of deductions over gross income was a net operating loss, a net operating loss carry-over to 1942, and (with adjustments not in controversy) a net operating loss deduction for 1942. *If* the language of section 122(d)(4) is to be given the meaning assigned to it by the law applicable to 1941, the deductions are so reduced by the exceptions and limitations provided in section 122(d)(4) that there is no net operating loss, no net operating loss carry-over to 1942 and no net operating loss deduction for 1942.

These simple facts present no issue (1) as to whether there was an excess of deductions over gross income in any year; (2) as to whether, or how, such excess might or should be applied as a net operating loss carry-back; or (3) as to whether, or how, such excess might or should be applied as a net operating loss carry-over to a second succeeding taxable year.

We may therefore, on the facts presented by this case, for all practical purposes, eliminate from this discussion all portions of respondent's brief which discuss and rely upon the subjects specified in the preceding paragraph.

The respondent states that "if the tables were turned" (Resp. Br., p. 50, footnote 36), and the petitioner had sustained the loss in 1943, which it was attempting to carry

back to 1941, the petitioner's theory would bar the deduction. That question also is not involved here, but the petitioner suggests that the respondent's assumption is not correct. The petitioner insists that the 1942 law governs in determining whether it may take a deduction in 1942 for a loss occurring in 1941, and the adjustments which must be made in determining the extent to which that loss is allowable. On the other hand, where the law applicable to 1942 provides that a 1942 loss may be carried back to 1941, the 1941 income be recomputed and a refund thereby be granted, there is no reason why the 1942 law does not govern. The respondent apparently assumes that because the petitioner has argued that the 1942 law applies in the computation of tax liability for 1942, the 1942 law applies only if there is involved the question of the computation of a 1942 tax liability. As was pointed out on pages 34, 35 of petitioner's main brief, no contention is made that the words "with respect to" are limited to the meaning "in the computation of tax liability for", nor was any such suggestion made in the *Moore, Inc.* case. What was said by the Tax Court in the *Moore, Inc.* case was that " 'with respect to" could mean *nothing less than* 'in computing a tax liability for' ". (Italics supplied.) We submit, therefore, that the respondent is attempting to create an argument on an entirely unwarranted assumption.

V.

There is no reason for computing a net operating loss except in connection with the determination of a net operating loss deduction.

The respondent takes exception (Resp. Br., p. 36) to the petitioner's statement that the provisions of section 122 of the Internal Revenue Code were purely academic in the

year 1941 so far as the petitioner was concerned. The petitioner had an excess of deductions over gross income in 1941 and, consequently, was not required to pay a tax. Whether section 122 of the Code provided for a net operating loss deduction and the manner in which such deduction was to be computed was, in fact, purely academic since nothing was allowable for 1941. The most that the petitioner had in 1941 was the hope that the law applicable to 1942 would permit the allowance of a net operating loss deduction and that the petitioner would continue in existence and have taxable income against which the deduction could be allowed. That the law applicable to 1941 did provide for such a deduction availed the petitioner nothing. Until the law applicable to 1942 was enacted, the petitioner could not be certain that any deduction at all would be allowed or what would be the amount thereof. Congress may have decided in 1942 that no net operating loss deduction would be allowed as it did in 1933.

VI.

The fact that a net operating loss deduction, on petitioner's theory may not be a constant is not an indication that Congress intended the 1941 law to apply.

It is true that on petitioner's theory, a net operating loss might not be a constant.* There is no indication that Congress intended it to be a constant. Apparently the respondent assumes that nothing so complicated is to be

* The petitioner's theory does not mean, as respondent assumes, that the amount of the net operating loss would change if a deduction not allowable under the law of one year were made allowable under the law of another year. The only change in the amount of the net operating loss, under the petitioner's theory, would occur if there were a change in the "exceptions, additions and limitations" provided in section 122(d).

attributed to Congress. We may properly ask whether it is more complicated and confusing to have a possibly variable net operating loss than it is to have the same language in section 122(d)(4) have a variety of meanings for the purpose of a single net operating loss deduction.

The position which the petitioner is contending for in this case does not involve any question of reaudit, administrative difficulty or the other results of which the respondent complains. In every case, there must be adjustments for the "exceptions, additions and limitations" provided in subsection (d) of section 122 for the year of the loss, for the year of the deduction and for the intervening year, if there be one. There is, we submit, no more question of reaudit or administrative difficulty in making the required adjustments under the law of a single year than there is in making the adjustments under the laws applicable to two or three different years. The adjustments must be made in any event. There is nothing in any way inconsistent in the taxpayer's position with the purposes or general structure of the net operating loss deduction provisions. As we will hereinafter point out, it does, in fact, carry out the averaging principle of the law, whereas, the respondent's position achieves the opposite result.

VII.

Respondent's theory is a distortion of the principle of averaging incomes and losses.

The respondent has stressed the argument that the purpose of the net operating loss provisions is to permit the averaging of income and losses over a period * (Resp. Br., pp. 17, *et seq.*; pp. 45, *et seq.*).

* On page 18 in footnote 4 of respondent's brief, reference is made to articles by L. Raum. Mr. Raum argued the instant case on behalf of the respondent in the United States Tax Court and, therefore, can hardly be considered an unbiased commentator.

The respondent has cited several examples to support his suggestion that the position contended for by the petitioner would be in conflict with that purpose of the statute (Resp. Br., pp. 48, *et seq.*). However, all of the respondent's examples are based upon an issue not involved in this case, that is, whether the 1941 or 1942 law governs in determining "the excess of the deductions allowed by this chapter over the gross income". As we have heretofore pointed out, that is a question not involved in this case and not necessary for decision. Respondent has carefully avoided stating whether the position which he urges this Court to adopt would, in the instant case, be consistent with the declared purpose of the statute to arrive at an averaging of income. However, the application of the respondent's theory to the instant case would be a clear distortion of, and inconsistent with, the theory of the averaging of incomes and losses. As we have heretofore pointed out, we are not concerned with a loss allowable as a deduction under the law of one year, but not under the law of the other year. The loss which the petitioner sustained on the worthlessness of the Reo Sales Corporation stock was allowable without restriction under the laws applicable to both 1941 and 1942. The position urged by the petitioner will result in a true averaging of the petitioner's loss and income for the years 1941 and 1942, whereas, the position urged by the respondent will result in the exact opposite.

Under the petitioner's theory, its loss and income will be truly averaged, and the amount of income upon which it will be taxed for the two years will be substantially the same and unaffected by the accident as to whether a particular item of income happened to be received or accrued in 1941 or 1942 or a particular item of deduction happened to be paid or incurred in 1941 or 1942. Under the respondent's theory, however, there will be no averaging what-

soever of the income upon which the petitioner must pay a tax and, hence, its tax liability will depend completely upon the particular year in which the income or deductions happen to be received or accrued or paid or incurred. For example, if $1,000,000 of the income which the petitioner received in 1942 had been received in 1941, the income upon which the petitioner would pay a tax for the two years would be identical with the amount of the income upon which the petitioner would pay a tax under the petitioner's theory on the actual receipt of the income in 1942. If the income of $1,000,000 had been received in 1941, it would have been offset by the petitioner's loss on the worthlessness of the stock of Reo Sales Corporation, and would have served merely to reduce the amount of the petitioner's net operating loss deduction allowable for 1942. Consequently, the petitioner's taxable income would remain the same in either case. Under the respondent's theory, however, the result would be quite different. If the petitioner had received the $1,000,000 in 1941, it would pay no tax thereon because the income would have been offset by the loss on the Reo Sales Corporation stock, which was fully allowable as a deduction against such income. On the other hand, having received the income in 1942 instead of 1941, the respondent insists that the petitioner pay a tax on such income on the ground that its unabsorbed loss in 1941 cannot be carried forward to offset such income in 1942. It requires a novel process of reasoning to urge in support of a position that the basic purpose of the statute is to permit an averaging of incomes and losses in a case where the application of that position will result in a total absence of averaging.

Throughout his brief, the respondent presents hypothetical examples which he suggests would achieve results which Congress could not have intended, examples, how-

ever, which are based upon the supposition that this case involves the question as to whether the excess of the deductions over the income shall be computed under the law of one year or another, an issue not involved in this case. It is significant that these examples, with one exception, referred to deductions allowable under the law of one year, but not under the law of the other, without any attempt to specify exactly what the deductions are. The example which the respondent cites on page 48 of his brief which does refer to a particular deduction refers to the deduction for amortizable bond premium. The example is, however utterly fallacious for two reasons: *First*, the deduction for an amortizable bond discount is provided for in sections 23(v) and 125 of the Code. However, section 125 of the Code provides in subsection (a) thereof setting forth the "General Rule" that the rules therein set forth shall apply to the amortizable bond premium on the bond "for any taxable year beginning after December 31, 1941". Congress was, therefore, careful to provide that the provisions with respect to the deduction for amortizable bond premiums were applicable not only in the computation of tax liability for taxable years beginning after December 31, 1941, but also only with respect to amortizable bond premiums for any taxable year beginning after December 31, 1941. Consequently, regardless of whatever interpretation of section 122 may be adopted, there is no basis upon which a taxpayer might argue that the amortization of bond premiums occurring *in* 1941 could, in any way, enter into the computation of a deduction. *Second*, corporation B in respondent's example cannot average income and losses for the simple reason that it had no loss.

VIII.

The respondent's answer to petitioner's argument on the Report of the Senate Finance Committee on the Revenue Bill of 1942 is unsound.

On pages 27 and following of petitioner's main brief there is set forth a discussion of the Report of the Senate Finance Committee which the petitioner submits fully supports its position. In attempting to answer the petitioner's argument, the respondent states (Resp. Br., p. 54): "That statement, upon which taxpayer relies (Pet. Br., p. 27), had reference, mainly if not entirely, to the fact that it was permissible under section 122(b) of the Code, as newly amended, not only to carry-over but to carry-*back* net operating losses to 1941, and the carry-back device was specifically made retroactive to cover the taxable year 1941." That statement is untrue, as the respondent knows, or at least should know. As he states on the same page of his brief, the same section of the statute provided that there was to be no carry-backs to years prior to 1941. Therefore, when the Senate Finance Committee stated "that the carry-overs to the taxable year 1941 from the taxable years 1939 and 1940 • • • will be determined under the amendments made by this section", it obviously was not talking about carry-backs. Since, under no circumstances, could anything be carried back to either 1939 or 1940, it is obvious that the carry-overs from 1939 to 1940 could, in no way, be influenced in the slightest by the provisions regarding carry-backs.

The respondent next attempts to avoid the effect of the Committee Report by referring (Resp. Br., p. 55) to the fact that the Committee was referring not to the determination of a net operating loss governed by subsections (a) and (d) of section 122, but to subsections (b) and (c) which

deal with carry-over and carry-back provisions. A similar argument is presented in the last paragraph of footnote 37 on page 56 of respondent's brief.*

As the respondent has pointed out several times in his brief, there are three steps required for the computation of a net operating loss deduction. The first is the computation of the "net operating loss". The second is the computation of the amount of the "net operating loss carry-back" and the "net operating loss carry-over", and third, the amount of the "net operating loss deduction". Each one of these steps requires an adjustment for some, or all, of the "exceptions, additions and limitations" provided in subsection (d). The taking of the three steps, however, is required only where there is an intervening year between the year of the loss and the year of the deduction. Section 122(b) serves no purpose whatsoever except to determine the amount of the loss which was used up in the intervening year and how much, therefore, remains to be carried over to the taxable year in question. If, as in the instant case, there is merely a carry-over from one year to the next, section 122(b) has no practical application and the net operating loss automatically becomes the net operating loss deduction, subject only to the additional adjustments required in subsection (c). If, on the other hand, we

* In this footnote, the respondent points out that the excess profits tax under subchapter E of the Internal Revenue Code was not allowable as a deduction in computing net income for taxable years beginning in 1942 and thereafter (section 23(c)(1)(B) of the Internal Revenue Code as amended by section 105(c)(1) of the Revenue Act of 1942). A deduction was allowed for such excess profits taxes for taxable years beginning in 1941 (section 23(c)(1)(B) and section 23(c)(2) of the Internal Revenue Code as amended by section 202(a) of the Revenue Act of 1941). However, as in the case of taxable years beginning in 1942 and thereafter, the excess profits tax under subchapter E of the Internal Revenue Code was not deductible in computing net income for taxable years beginning in 1940 (section 23(c)(1) of the Internal Revenue Code as amended by section 500 of the Second Revenue Act of 1940).

have an intervening taxable year, the question is different. If we assume that the three years 1939, 1940 and 1941 referred to in the Committee Report are involved, we have the following situation:

(1) We must first compute the amount of the net operating loss for 1939. The respondent will necessarily argue, as he does in the instant case, that the excess of deductions over the gross income for 1939 must be computed under the law applicable to 1939, a question not involved in this case. He will then argue that the exceptions and limitations provided in subsection (d) must also be computed under the law applicable to 1939, and not for the year 1941, the year for which the deduction is being computed.

(2) The next step will be the computation of the net operating loss carry-over under section 122(b). This will involve a consideration of the net income for 1940 with the exceptions and limitations of subsection (d) therein required, which may result in a decrease in the amount to be carried over to 1941, depending upon whether 1940 resulted in a profit or a loss. We are, therefore, faced with the same problem initially encountered for the year 1939. The income and the deductions for 1940 must be computed under either the 1940 or 1941 law. The exceptions and limitations must also be computed under the 1940 or the 1941 law. This is the point which the respondent has carefully tried to avoid committing himself on in his brief. The reason obviously is that if he admits that the 1941 law controls in making the adjustments in the 1940 income, his position would be completely inconsistent with his position for 1939, and there is no basis in the statute or reason for the inconsistency. On the other hand, he apparently realizes that if he argues that the law applicable to 1940 controls, he is taking a position equally as inconsistent with the statements of the Senate Finance Committee.

(3) The third step will be the computation of the net operating loss deduction again involving an adjustment for exceptions and limitations under section 122(d).

What the respondent's position actually is is difficult to determine from his brief. On page 39, he says: "The first step, on the one hand, and the second and third, on the other, are normally controlled by the law of different years." This seems to say that the second and third steps will be controlled by the law of the same year. Yet, the language on page 40 in footnote 29 seems to say that the adjustment of the intervening year will be determined under the law applicable to the intervening year. To create still greater confusion, the respondent says in the last paragraph of footnote 37 on page 56: "If this is so, it is because the new Sections 122 (b) and (c) expressly control net operating loss carry-overs to, and net operating ~~loss deductions~~ in, 1941, and in that connection determine the extent to which a prior net operating loss, which is to be carried to 1941, may be offset in 1940." The last quoted statement adopts completely what the Senate Finance Committee said and at least seems to be inconsistent with the statement in footnote 29, page 40 of respondent's brief. Section 122(b) applies only to the adjustments for the intervening year. The term "carry-over" is a term of art which is defined in section 122(b). When the Senate Finance Committee stated that a carry-over to the year 1941 would be computed under a statute applicable only to 1941 and subsequent years, it was clearly stating that the amount of the carry-over from 1940 would be computed under the law applicable to 1941.

The respondent specifically says that the laws applicable to 1941 and not prior thereto "determine the extent to which a prior net operating loss, which is to be carried to 1941, may be offset in 1940". If this means, as it seems to mean and as the Committee Report stated, that section

122(d) as it existed in 1941 controls the "exceptions, additions and limitations" to be made in the 1940 income in determining the amount of the carry-over, what possible basis can there be for arguing at the same time that section 122(d), as it existed in 1941, does not apply in determining the exceptions and limitations which must be made in the 1939 income to determine the net operating loss for that year?

If the respondent's position is not as stated on pages 29 and 30 of petitioner's brief, but which respondent disclaims in footnote 31, page 41, of his brief, he should state with more exactness what his position is. If his position is not that which the petitioner ascribed to him, then we submit that there is a fatal inconsistency between his proposed method of computing a "net operating loss" and a "net operating loss carry-over" which cannot be justified on any basis of statutory construction, principle or reason.

IX.

The Tax Court of the United States has not rejected the *Moore* case.

The respondent, at several points in his brief (Resp. Br., p. 14, footnote 1; p. 64 and footnote 43), has pointed out that the *Moore, Inc.* case was not reviewed by the full Tax Court, whereas, the instant case was so reviewed and only Judge LEECH who wrote the opinion in the *Moore, Inc.* case dissented. The inference which these statements are apparently intended to create is that 15 of the 16 Tax Court Judges do not accept the decision in the *Moore, Inc.* case or the reasoning upon which it is based. We submit that any such inference would be entirely unwarranted. The majority of the Tax Court, in the instant case, gave no indication

that they did not agree that the provisions of section 122(d), as they existed in 1942, were applicable in determining the adjustments to be made in arriving at the amount of the net operating loss. They apparently were misled into believing that a different issue was here involved because there also was an amendment to section 23(g), although the respondent now seems to admit that that fact does not create a different issue. The majority of the Tax Court in *Community Public Service Co.* v. *Com'r* (12 T. C. 893) cited the *Moore, Inc.* case with approval. The three dissenting Judges did not base their opinion on the ground that the *Moore, Inc.* case was incorrectly decided, but on the ground that the *Moore, Inc.* case "involved an entirely different statute" and "I do not think it is in point here". *Community Public Service Co.* v. *Com'r* involved the question as to whether the taxpayer's "unused excess profits credit" for prior years should be computed upon an entirely different basis than was provided by the law applicable to the determination of tax liability for such prior years. The question in that case is, therefore, more analogous to the question as to whether the petitioner's income and deductions for 1941 should be computed under the 1941 or 1942 law, a question not involved here, rather than the question actually involved in this case, which is whether in computing the deduction for 1942, the petitioner's loss for 1941 should be subjected to the adjustments required by the 1942 law, the law granting the deduction.

The decision of the Tax Court in *Cambria Collieries Co.* v. *Com'r* (10 T. C. 1172) was not stated to be, and in fact is not, inconsistent with the *Moore, Inc.* case. That case involved a carry back and not a carry over. In addition, it involved the question of a deduction allowed under one law and not the other. It did not involve the question of an adjustment required under section 122(d).

X.

Section 710(c)(1) of the Internal Revenue Code does not support the respondent's position.

On page 34 of his brief the respondent argues that if Congress had intended that the "exceptions, additions and limitations" of section 122(d), as it existed in 1942, should apply, it should have specifically so provided. By way of analogy, reference is made to section 202(e) of the Revenue Act of 1941 which amended Code section 710(c)(1). Prior to amendment, Code section 710(c)(1) provided:

> The term "unused excess profits tax credit" means the excess, if any, of the excess profits credit for any taxable year beginning after December 31, 1939, over the excess profits net income for such taxable year, *computed on the basis of the excess profits credit applicable to such taxable year.* (Italics supplied.)

Section 202(e) of the Revenue Act of 1941 provided:

> Section 710(c)(1) (defining the unused excess-profits credit) is amended by adding at the end thereof a new sentence to read as follows:
>
> "For such purpose the excess-profits credit and the excess-profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941."

Thus the amendment to section 710(c)(1) to provide that the credit for 1940 should be computed under the law applicable to the year 1941, was not in pursuance of any general plan of providing in the statute for an explicit statement to that effect when it was intended that the law of the current year should govern. The exception was necessary because the original section of the Code itself already contained an exception, that is, that the credit was to be com-

puted for any taxable year "on the basis of the excess profits credit applicable to such taxable year". The provisions of section 710(c)(1) are therefore entirely consistent with the petitioner's position, *i. e.*, where Congress intends that the law of the earlier year shall apply, it specifically so provides. This is what Congress did in Code section 710(c)(1) as originally enacted and the amendment effected by section 202(c) of the Revenue Act of 1941 was for the purpose of providing for an exception for a single year only, 1940.

The one question which must be answered in this case is whether section 122(d) as it existed in 1942, or as it existed in 1941, determines the "exceptions, additions and limitations" required to be made in determining the amount of the net operating loss for 1941. A decision for the petitioner or for the respondent will follow automatically when that single question has been answered. The respondent accuses the petitioner of having assumed a favorable answer to that question and then built an argument thereon. The petitioner may reply that much of the respondent's argument is similarly premised upon the assumption of an answer favorable to him of that question. The petitioner concedes that its whole argument fails if the foregoing question is answered against it. We wish to point out, however, that the arguments of the respondent which sound plausible, having assumed his answer to the basic question, likewise fall completely if that question is answered otherwise. We wish to point out again that the respondent's position, upon which his whole argument is based, that section 122(d) as it existed in 1941 is determinative, is necessarily either inconsistent and in conflict with his position as to the version of section 122(d) which is applicable in determining the adjustments to be made in the income of an intervening

year, or inconsistent and in conflict with the statements of the Senate Finance Committee in connection with section 153 of the Revenue Act of 1942.

On page 44 of his brief, the respondent argues that the construction urged by the petitioner might result in a net operating loss carry-over from a year in which the taxpayer had net income under the law controlling that year, and for which it had to pay a tax, and, therefore, had no actual loss at all. The respondent then quotes from a report of twenty-five years ago on the Revenue Act of 1924 to argue that such a result would be "anomalous". The petitioner does not know whether a case will ever arise in which the application of its theory might result in a net operating loss carry-over from a year in which there was net income and a tax was paid. The petitioner does wish to point out that, entirely without regard to whether its position or the respondent's position is sustained, it is possible that a taxpayer may have income for a year and pay a tax thereon and, at the same time, have a net operating loss for that year. See the example set forth in the footnote on page 19 of petitioner's brief in support of its petition for writ of certiorari. This results from the unambiguous provision of section 122(d). as it presently exists, which permits the full amount of long-term capital losses to be offset against short-term capital gains, although in the case of individuals, long-term capital losses may be taken into account only to the extent of 50 per centum thereof in the computation of the tax liability for the year in which such losses occur. Furthermore, the provisions of section 122 require an adjustment for the "exceptions, additions and limitations" provided in subsection (d), and thereby provide that a deduction for excess profits taxes under section 122(d)(6) shall be allowed in the computation of the net operating loss although it was not permitted in computing

the net income for the year. Apparently, the Congress of 1942 and subsequent Congresses have not shared the views expressed by the Ways and Means Committee in 1924. Congress has now provided at least two ways in which a taxpayer may have a net operating loss although it had taxable income and paid an income tax for the same year, one through the different treatment of long-term capital losses, and the other, through the payment of an excess profits tax in the year, which is an additional deduction allowed in computing the net operating loss but not allowed in computing the net income for the year.

The respondent admits that under petitioner's theory the petitioner "will not 'gain an extra deduction'" (Resp. Br., p. 53). The respondent argues strenuously that the whole net loss theory is based upon "the prime purpose of Congress to secure approximate tax equality (a) between businesses with stable profits and those with fluctuating earnings, and (b) among taxpayers suffering losses in some years and earning profits in others" (Resp. Br., p. 45). Yet, the respondent's theory achieves exactly the opposite result. The respondent has presented not a single reason in logic why the deduction should not be allowed to the petitioner. His entire argument is based upon the possible, but improbable, results in a quite different case involving the meaning of "by this chapter" in the phrase "excess of deductions allowed by this chapter over the gross income", and not dependent upon the principles here involved.

JAMES O. WYNN,
N. BARR MILLER,
Attorneys for Petitioner,
Investment Building,
Washington 5, D. C.